



STATE OF NORTH CAROLINA

DEPARTMENT OF PUBLIC INSTRUCTION
DIVISION OF SCHOOL SUPPORT, CHILD NUTRITION SERVICES
FINANCIAL RELATED AUDIT

DECEMBER 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

December 9, 2011

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
State Board of Education
The Honorable Dr. June St. Clair Atkinson, State Superintendent,
Department of Public Instruction

This report presents the results of our financial related audit at the Division of School Support, Child Nutrition Services of the Department of Public Instruction. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The audit was initiated by the North Carolina General Assembly. Session Law 2011-342, section 3 states:

The State Auditor shall audit the Division of School Support, Child Nutrition Services of the Department of Public Instruction. The audit shall determine whether the local school administrative units' participation in the federally supported food service programs effectively serve the intent of the General Assembly and comply with federal and State law and regulations.

The results of our audit disclosed no internal control deficiencies or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. Although there were no reportable findings, our report answers questions posed by members of the General Assembly regarding the Child Nutrition Services' nutrition programs.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

INTRODUCTION

The Department of Public Instruction participates in the National School Lunch Program (School Lunch Program) and the School Breakfast Program. These food service programs are administered by the Division of School Support, Child Nutrition Services Section in accordance with federal guidelines as established by the Food and Nutrition Service of the United States Department of Agriculture.

The School Lunch Program is a federally assisted meal program operating in public schools, nonprofit private schools, and residential child care institutions. The Program provides nutritionally balanced, low-cost or free lunches to children each school day. The School Breakfast Program provides cash assistance to states to operate nonprofit breakfast programs in schools and residential childcare institutions. State education agencies administer the School Breakfast Program at the state level, and local education agencies operate the program in schools.

In North Carolina, approximately 800,000 children benefit from the School Lunch Program per school day and approximately 260,000 participate in the School Breakfast Program per school day.

OBJECTIVES, SCOPE, AND METHODOLOGY

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a financial related audit at the Division of School Support, Child Nutrition Services. This audit was initiated at the request of the North Carolina General Assembly.

The objectives of a financial related audit may include determining whether (1) the organization has complied with finance-related laws, regulations, and provisions of contracts or grant agreements; (2) assets have been safeguarded; (3) financial resources have been prudently managed; and/or (4) improvements are needed in internal control over any of these fiscal matters or in internal control over accounting and financial reporting functions. The specific objectives for this engagement included: determining if the notification of federally-funded child nutrition programs is adequate; determining if the School Breakfast Program is available in all schools; providing a description of eligibility and verification procedures; and determining if the Department reports on whether verification processes over eligibility determinations are followed consistently throughout the State. These objectives were defined after consulting with the sponsor of the Senate Education Subcommittee and Senate President Pro Tempore.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

To accomplish our audit objectives, we gained an understanding of internal control over matters related to our audit objectives and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing records, conducting a statewide survey of local child nutrition administrators, and examining documentation supporting controls. Whenever sampling was used, we applied a nonstatistical approach but chose sample sizes comparable to those that would have been determined statistically.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this audit in accordance with generally accepted government auditing standards applicable to performance audits. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit scope included a review of Department and School Breakfast Program policies, procedures, and activities during the period July 1, 2010, to October 31, 2011.

RESULTS

The results of our audit disclosed no internal control deficiencies or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. Items described in the Audit Findings Section of this report answer questions posed by members of the General Assembly.

AUDIT FINDINGS AND RESPONSES

1. DO THE DEPARTMENT OF PUBLIC INSTRUCTION AND LOCAL EDUCATION AGENCIES PROVIDE ADEQUATE NOTICE TO THE PUBLIC ABOUT FEDERALLY-FUNDED CHILD NUTRITION PROGRAMS?

The Department of Public Instruction (the Department) and local education agencies (LEAs) provide adequate notification to the public about federally-funded child nutrition programs.

The LEA is responsible for publicly announcing the availability of the federally-funded child nutrition programs and its associated criteria. Regulations require that LEAs distribute letters to all student households at the beginning of every school year. Among other requirements, this letter notifies families about which school nutrition programs are available and that meals may be available free or at a reduced price. Each LEA is responsible for determining other strategies for communicating with households.

In addition to any local efforts, the Department also distributes a media release to media outlets. Once distributed, the media release is posted to the Department's general website and to the Child Nutrition Services Section's website.

We surveyed child nutrition administrators statewide to determine common means LEAs and schools used to notify parents of the federally-funded child nutrition programs' availability. We found on average each LEA/school used an average of four ways to communicate the programs' availability:

- Letter to household (100%)
- District Website (70%)
- New enrollment packets (67%)
- Announcements at meetings, e.g., PTA meeting or open houses (62%)
- Local newspaper (43%)
- Automated call to parents (34%)

In addition, the Department coordinates with the State's Migrant Education Program Coordinator to promote notification of availability and eligibility to Migrant students to ensure these families are aware of the Child Nutrition Programs and the eligibility guidelines.

Recommendation: None.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

2. IS THE SCHOOL BREAKFAST PROGRAM AVAILABLE IN ALL SCHOOLS? ARE ALL OF THE SCHOOLS PARTICIPATING IN THE REQUIREMENTS OF SENATE BILL 415 TO ELIMINATE THE COST OF REDUCED PRICE BREAKFAST MEALS?

The School Breakfast Program is available in almost all schools. All schools that offer the School Breakfast Program use Senate Bill 415 (SB 415) funding to eliminate the cost of breakfast for children that qualify for reduced priced meals.

Senate Bill 415 appropriated funds to provide school breakfasts at no cost to students qualifying for reduced-price meals in all schools participating in the National School Breakfast Program as of July 1, 2011. The Department created a plan to implement the requirements of SB 415 in August 2011.

To assess participation in the School Breakfast Program and the changes brought about by Senate Bill 415, we surveyed all 185 local education authorities (LEAs) and schools authorized to administer federally-funded Child Nutrition Programs. A total of 143 LEAs and schools responded to our survey.

Of the 2,377 schools represented in the survey, only 24 (1%) do not participate in the School Breakfast Program.¹ Reasons schools cited for not offering breakfast included historically low participation and transportation or bus schedule issues. According to our survey results, all schools who offer breakfast meals offer free breakfast meals to students receiving reduced-price lunch meals as per SB 415.

The Department allocated funds to all eligible LEAs and schools based on the number of students eligible for reduced-price meals as of September 30, 2010. This allocation formula was designed to ensure that all LEAs receive an equitable allocation of the available funds. The current year allocation is adequate to reimburse LEAs the cost of reduced-price breakfast meals at a 33.17% student participation rate.

If student participation rates increase, current year SB 415 funding will be inadequate to cover the additional cost of reduced-price breakfast meals at the LEA. The decision to continue the program, once the initial allocation is fully dispersed to the LEA, is the responsibility of the local board of education. LEAs and schools will have to identify other funding to continue the program or charge students the reduced breakfast rate.

Recommendation: None.

¹ Seventeen early college schools were eliminated from this analysis because students do not report to the school until after breakfast meals would be served.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

3. WHAT ARE THE ELIGIBILITY PROCEDURES NORTH CAROLINA USES TO QUALIFY CHILDREN FOR FREE AND REDUCED PRICE MEALS? DOES NORTH CAROLINA USE PROCEDURES THAT ARE DIFFERENT FROM, OR IN ADDITION TO, THE REQUIRED FEDERAL PROCEDURES?

The Department of Public Instruction (the Department) uses written eligibility guidance procedures established and published by the US Department of Agriculture (USDA) to determine student eligibility for the federally-funded child nutrition programs.

Students can become eligible to participate in the free and reduced-price meals program through direct certification or by completing an application.

Direct Certification

Federal regulation requires direct certification. Direct certification is a way to determine free and reduced-price meal benefit eligibility without an application. Local education agencies (LEAs) obtain data about individuals who receive assistance directly from the authorities who offer assistance (e. g food stamps and temporary assistance). LEAs compare data obtained from authorities to their student rolls to identify matches for direct certification.

Application Process

The Department requires LEAs to enter into an agreement in order to be eligible to administer the federally-funded child nutrition programs. The Department includes a free and reduced-price Application in the agreement packet with all of the federally required criteria.

The most substantial eligibility requirements are household income requirements. Income eligibility guidelines for free and reduced price meals are based on household size and income levels as prescribed annually by the United States Secretary of Agriculture. Free meals are available to students who live in households at or below 130 percent of the federal poverty level and reduced price meals are available to students who live in households between 130 and 185 percent of the federal poverty guidelines.

Additional North Carolina Procedures

The Department is not required to provide, review, or approve child nutrition program applications that LEAs distribute to parents; however, the Department provides template applications that include all of the federal criteria. If the LEA does not use the template, then the Department reviews the LEA's application to ensure that all necessary elements are included.

The Department is not required to have an automated direct certification system, but a system was created to electronically match students from the Department's student information database to the state's Department of Health and Humans Food and Nutrition Services data.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Department's direct certification system was recognized in USDA's 2010 Report to Congress distinguishing North Carolina as one of the top States in direct certification effectiveness. The automated system eliminates the need for a paper application, thus minimizing the risk of human error in reporting and/or calculating income at various intervals. According to the Department's calculations, direct certification has eliminated the need for approximately 470,000 household applications this year alone.

Recommendation: None.

4. DOES THE DEPARTMENT OF PUBLIC INSTRUCTION VERIFY THAT ELIGIBILITY PROCEDURES ARE BEING FOLLOWED CONSISTENTLY THROUGHOUT THE STATE? DOES NORTH CAROLINA USE A VERIFICATION PROCESS THAT IS DIFFERENT FROM, OR IN ADDITION TO, THE REQUIRED FEDERAL PROCEDURES?

The Department of Public Instruction (the Department) verifies that eligibility procedures are being followed consistently throughout the state. The Department performs some review procedures that are in addition to the federal requirements. However, these additional procedures do not require significant additional time and provide appropriate oversight that is consistent with federal guidelines.

The Coordinated Review Guidance manual (the manual) issued by the United States Department of Agriculture (USDA) outlines in detail the procedures to be performed by state agencies to evaluate local education agencies (LEAs) that participate in the school lunch program. The Department uses this manual to verify student eligibility in the lunch and breakfast programs at LEAs and individual schools.

The manual requires an initial comprehensive on-site evaluation including both critical and general areas of review. The manual also describes the required procedures for selecting schools for the administrative reviews.

Critical Areas of Review

USDA outlines critical areas of review to ensure uniformity in the evaluation process. Items that are evaluated as a part of the critical review include: eligibility certification, claiming procedures, benefit award, on-site observation, and meal components.

General Areas of Review

USDA requires specific items be included in the general review. However, state agencies may develop additional procedures for the general areas as a part of the state agency's oversight responsibility. Items that are evaluated as part of the general review include: the free and reduced price process and meal patterns, civil rights compliance, local education agency monitoring responsibilities, and reporting and recordkeeping. Additional areas of general review implemented by the Department are discussed under the header "Additional Review Areas."

AUDIT FINDINGS AND RESPONSES (CONTINUED)

School Selection Procedures

Each LEA must be reviewed at least once during the established five year cycle with no longer than six years between reviews. State agencies are encouraged to conduct more frequent administrative reviews of large LEAs and of any LEA which may benefit from a more frequent interval. There is no per year minimum number of reviews to be conducted. States are afforded the flexibility to schedule reviews within the cycle based on state agency considerations.

When selecting schools for administrative review, the Department must use the procedures and criteria as required by the Coordinated Review Guidance manual published by the USDA in 1993. The minimum numbers of schools within the LEA that must be selected for review is determined using the following table:

Number of Schools in the LEA	Minimum number of Schools to Review	Number of Schools in the LEA	Minimum Number of Schools to Review
1 to 5	1	41 to 60	6
6 to 10	2	61 to 80	8
11 to 20	3	81 to 100	10
21 to 40	4	101 or More	12*
*12 plus 5% of the number of schools over 100. Fractions must be rounded to the nearest whole number.			

Source: Coordinated Review Guidance, USDA, Food and Nutrition Services, 1993

Central Office Review

During their annual Coordinated Review Effort, the Department reviews eligibility procedures performed by LEAs to determine the accuracy and consistency of the procedures throughout the State. All LEAs that participate in the School Lunch and School Breakfast programs are reviewed on a rotational basis to ensure that all LEAs are monitored at least once in each five year period as required by federal regulations.

When the LEA undergoes the Coordinated Review Effort (the review), the Department reviewers examine the verification procedures performed at the central office as well as a sample of individual schools within the LEA. During each review the free and reduced-price applications and the verification process completed by the LEA are inspected. Student eligibility verification performed by the LEA is confirmed through review of the free and reduced-price applications to determine that student eligibility status is consistent with USDA eligibility guidelines. Accuracy of the benefits award is also confirmed to ensure that students are receiving the level of benefits to which they are entitled.

During each central office review, the verification sample completed by the LEA is reviewed in its entirety. The Department reviews 100% of all applications verified by the LEA, although federal regulations only require state agencies to review a statically valid sample of

AUDIT FINDINGS AND RESPONSES (CONTINUED)

applications and verification documents submitted by the household. Reviewers examine the documentation submitted by the households selected for review to ensure the documents are appropriate forms of household income documentation. Review teams then recalculate the income reported on the application to ensure the income reported is accurate and that household benefits were appropriately issued. Department reviewers verify the LEA took appropriate action to notify the household if incorrectly issued household benefits were identified, and also confirm that households were notified of any changes in benefits in a timely manner.

Individual School Review

As a part of the Coordinated Review Effort, the Department's review teams also select a certain number of individual schools within the LEA for administrative review based on guidance in the USDA review manual. As part of the administrative review, the Department will review 100% of applications for free and reduced priced meals at the school to ensure that eligibility was determined correctly, although federal regulations only require state agencies to review a sample of 10% of applications and documents submitted by the household. Review teams also perform review of critical and general area review items as prescribed by the USDA review manual. This review consists of items such as eligibility certification, claiming procedures, benefit issuance, on-site observation, meal components, free and reduced price process, meal patterns, civil rights compliance, monitoring responsibilities, and reporting and recordkeeping.

Additional Review Areas

As mentioned above, the Department review teams perform additional items of review during the normal Coordinated Review Effort cycle to achieve a level of assurance with which members of Department management are comfortable. These items include a review of the School Breakfast Program, the after school snack program, financial management procedures, food service management contracts, and procurement.

Although it is not required, USDA guidance encourages additional review to be completed in such areas as procurement, food service management, sanitation, financial management, and parent and student involvement as a part of the state agency's oversight responsibility. These items do not require an extreme amount of additional time and effort to complete, as review teams are already in place performing other items of review. Department Management stated that the amount of time is negligible as the importance of the procedures outweighs the amount of time spent. We agree that the additional review items add to the strength of state monitoring practices over the School Lunch and School Breakfast Programs and help ensure consistency of the programs throughout the state.

At the conclusion of the administrative review process, a corresponding report documenting the results of the review, including any deficiencies is issued to the LEA and to the individual schools that are the subject of the review. If such deficiencies are noted, a written corrective action plan, approved by the Department, is required for any areas of non-compliance identified in the review. Non-compliance or failure to take corrective action by the LEA may result in the Department withholding federal funds. Any financial penalty taken against an LEA is reflected in a deduction from reimbursement payments.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

The Department monitors progress on corrective action until all findings are adequately addressed at which point the review is finalized and closed.

As a part of the state fiscal year 2010-2011 coordinated review schedule, the Department completed 39 coordinated reviews. We reviewed 12 (30%) of the coordinated review efforts, including at least one from each region of the state. In all 12 instances, the reviews were completed in their entirety and included all levels of review as required by USDA.

Recommendation: None.

5. DOES THE DEPARTMENT OF PUBLIC INSTRUCTION REPORT ON WHETHER VERIFICATION PROCESSES OVER ELIGIBILITY DETERMINATIONS ARE FOLLOWED CONSISTENTLY THROUGHOUT THE STATE?

The Department of Public Instruction (the Department) is performing all reporting procedures as required by state and federal policies.

Verification Summary Reports

All Local Education Agencies (LEA) are required to complete the verification process annually. The LEAs are required to report the results of their verification procedures to the Department through completion of the Verification Summary Report on or before March 1 of that academic year. LEAs submit the Verification Summary Report annually whether they are subject to a coordinated review or not. The Department is required to review and approve all reports submitted by the LEAs.

The Verification Summary Report enables the LEA to report the number and types of meal benefits issued to students. The Department reviews the Verification Summary Reports from each LEA to ensure: (1) that the number of students reported equals or is less than the LEA's average daily membership as of October 1; (2) the LEA implemented the correct sampling method and the correct sample size; (3) the correct number of applications were selected for verification based on the required sample size; and (4) the LEA reported the correct number of households that were selected for the verification sample.

The Department is required to submit a statewide Verification Summary Report annually to the United States Department of Agriculture (USDA) no later than April 15 of the review year. The state report contains the consolidated reports from all of the submitted LEA reports.

USDA Oversight

USDA reviewers are required to monitor how state agencies conduct the Coordinated Review Efforts (CRE). Federal reviewers are onsite during the year while the Department is conducting CREs to ensure that the Department's practices are in compliance with federal

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

policy and USDA guidance. USDA reviewers inspect the CRE automated process and observe the Department review teams as they conduct the reviews.

In addition, USDA reviewers come to the Department every 2 - 3 years where they review all aspects of the CRE and other areas to determine whether the Department is operating in compliance with federal regulations. During the week of September 12 - 16, 2011, a five-person Management Evaluation team came from USDA to review the Department's work. USDA reviewers had no findings.

Other Reporting

Other than the reports previously mentioned, the Department is not required to report on specific findings from its CRE to any other authority. In addition, the Department does not maintain a database of findings. It is management's stance that to do so would serve no statutory requirement or other useful purpose and would require additional staffing. Without findings being compiled in a database or maintained in a central system it is possible that common findings that occur in multiple LEAs or reoccurring findings are not being addressed as adequately as they could be.

Recommendation: The Department should implement a tool to track and organize findings during CRE cycles. With the findings identified, training could be provided or other appropriate steps could be planned to address the issue prior to scheduled CREs.

Agency Response: The Department currently reviews CRE findings/trends on a monthly basis. These trends are documented in the monthly CRE team meeting notes and are considered when planning training for School Food Authorities. In addition to the CRE team meeting notes, the Department agrees to track the findings in an organized, systematic format beginning with the 2011 -2012 review cycle.

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